CV-16-11325-00CL
Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

BETWEEN:

ERNST & YOUNG INC.
in its capacity as Court Appointed Receiver
of HANFENG EVERGREEN INC.

Plaintiff

- and -

YU XINDUO and LEI LI

Defendants

STATEMENT OF CLAIM

TO THE DEFENDANT

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiff. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the Rules of Civil Procedure, serve it on the plaintiff's lawyer or, where the plaintiff does not have a lawyer, serve it on the plaintiff, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

IF YOU PAY THE PLAINTIFF'S CLAIM, and $4,000.00 for costs, within the time for serving and filing your statement of defence, you may move to have this proceeding dismissed by the court. If you believe the amount claimed for costs is excessive, you may pay the plaintiff's claim and $400.00 for costs and have the costs assessed by the court.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date March 22, 2016

Issued by ______________________
Local registrar

Address of court office
330 University Avenue
7th Avenue
Toronto, Ontario

TO: YU XINDUO
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LEI LI
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CLAIM

1. The plaintiff claims:

   (a) as against the Defendant, Yu Xinduo ("**Yu**"):

   (i) restitution or damages, in the amount of Canadian currency sufficient to purchase Chinese Yuan Renminbi (RMB) 630,000,000 for breach of fiduciary duties owed to Hanfeng Evergreen Inc., fraud, conversion or unjust enrichment;

   (ii) damages for breach of fiduciary duty in an amount of Canadian currency sufficient to purchase RMB 235,600,000;

   (b) as against the Defendant, Lei Li ("**Lei**"):

   (i) restitution or damages, in the amount of Canadian currency sufficient to purchase RMB 630,000,000 for knowing assistance and knowing receipt;

   (c) as against both Defendants, jointly and severally:

   (i) damages for fraudulent misrepresentation in an amount of Canadian currency sufficient to purchase RMB 235,600,000;

   (ii) a declaration that all monies belonging to Hanfeng Slow-Release Fertilizer Co., Ltd. and wrongfully obtained by Yu and/or held by Lei are held in a constructive trust in favour of the Plaintiff;

   (iii) aggravated, exemplary and punitive damages in the amount of $500,000;

   (iv) special damages in an amount to be determined in advance of trial, for costs, including but not limited to those incurred by the Plaintiff in connection with Court approval and monitoring of the Share Transfer Agreement (defined below) and in connection with the delays to the Share Transfer Transaction (defined below) caused by Yu and Lei as well to investigate the activities of Yu and Lei and to preserve the assets of Hanfeng Slow-Release Fertilizer Co., Ltd.;

(v) the costs of this action plus applicable taxes;

(vi) prejudgment and postjudgment interest pursuant to the *Courts of Justice Act*, RSO 1990, c C.43 ("***CJA***"); and

(vii) such further relief and other relief as counsel may advise and this Honourable Court deem just.

Parties

2. Hanfeng Evergreen Inc. ("**Hanfeng**") is incorporated under the laws of Ontario with its registered head office in Toronto. Through its wholly-owned subsidiaries, Hanfeng was a developer and producer of value-added fertilizers in the People's Republic of China ("**China**"). Hanfeng has no independent operations and exists solely as a holding company for certain operating entities located in China.

3. Hanfeng Slow-Release Fertilizer Co., Ltd. ("**Hanfeng China**") provides slow-release fertilizer products for landscaping projects and agriculture in China. Hanfeng China is a wholly-owned subsidiary of Hanfeng.

4. Yu is a resident of Ontario and is the founder and former CEO of Hanfeng, who owns and controls approximately 20.4% of Hanfeng's shares. At all material times, Yu was a director of Hanfeng. Yu is also the legal representative of Hanfeng China, a position that makes Yu responsible for the overall activities of Hanfeng China under Chinese law.

5. Lei is the spouse of Yu, is a resident of Ontario and is a former director and officer of Hanfeng.

6. Ernst & Young Inc. is a professional services firm and was appointed as receiver and manager of Hanfeng (the "**Receiver**") on August 20, 2014 pursuant to an Order under section 101 of the *CJA* and in that capacity brings this action on behalf of Hanfeng and creditors of Hanfeng.

Overview

7. On or about August 8, 2014, Hanfeng entered into a share transfer agreement pursuant to which a purchaser would purchase its shares of Hanfeng China. Unbeknownst to Hanfeng, Yu and Lei fraudulently misrepresented the identity and corporate history of the purchaser with the result that Hanfeng believed it was entering into the share transfer agreement with an established and reputable company, when in fact the purchaser was a shell corporation established and controlled by Yu.

8. Prior to the appointment of the Receiver and during his tenure as a director of Hanfeng, Yu breached his fiduciary duties to Hanfeng and his duties to Hanfeng China by taking out a series of loans on behalf of Hanfeng China, the proceeds of which he converted for his own use or otherwise improperly dissipated to the detriment of Hanfeng and Hanfeng China.

9. Following the appointment of the Receiver, Yu continued to breach his duties to Hanfeng and Hanfeng China by frustrating the efforts of the Receiver to close the share transfer agreement, hindering the appointment of a new legal representative for Hanfeng China and improperly retaining and dissipating Hanfeng China property, all in breach of orders of this Court.

Background

The Share Transfer Agreement

10. In June 2014, Yu and Lei forwarded a letter of intent dated June 16, 2014 to the Board of Directors of Hanfeng (the "**Board**") on behalf of a potential purchaser (the "**Purchaser**") expressing interest in acquiring Hanfeng China from Hanfeng (the "**Letter of Intent**"). The Letter of Intent was purportedly authored by Heilongjiang

Pengcheng Fertilizer Co., Ltd. ("**HLJ Pengcheng**"), a well-known, well-capitalized and reputable fertilizer company in China. Yu and Lei also represented to the Board that the Purchaser was HLJ Pengcheng and that the Purchaser was a third party purchaser at arm's-length to Hanfeng China.

11. The Board retained Deloitte LLP to conduct due diligence on HLJ Pengcheng and prepare a fairness opinion with respect to the proposed transaction.

12. On August 8, 2014, following negotiations, Hanfeng and the Purchaser entered into a share transfer agreement (the "**Share Transfer Agreement**") and certain related agreements pursuant to which Hanfeng agreed to transfer all its equity shares of Hanfeng China to the Purchaser in consideration for payment of RMB 248,000,000 (approximately C$50 million) (the "**Share Transfer Transaction**"). Eighty percent of the purchase price was payable in cash and 20% was payable by way of a non-interest bearing promissory note to be issued by the Purchaser in favour of Hanfeng.

13. As detailed below, Yu and Lei misrepresented and concealed the true identity of the Purchaser. Contrary to the Defendants' representation, the Purchaser was not HLJ Pengcheng (Heilongjiang Pengcheng Fertilizer Co. Ltd.), but rather was a shell corporation with a confusingly similar name, Heilongjiang Harbin Pengcheng Fertilizer Co. Ltd. ("**Harbin Pengcheng**"), set-up by Yu and others.

14. The Receiver later discovered that although the Letter of Intent was purportedly authored by HLJ Pengcheng and its negotiations were purportedly conducted with authorized representatives of HLJ Pengcheng, in fact HLJ Pengcheng had no knowledge of the Letter of Intent or the Share Transfer Agreement and had no involvement in the negotiations with Hanfeng.

The Receivership Proceedings

15. On August 20, 2014, Hanfeng commenced an application (the "**Application**") in the Ontario Superior Court of Justice seeking appointment of Ernst and Young Inc. as receiver and manager of the assets, undertakings and property of Hanfeng pursuant to section 101 of the *CJA* (the "**Receivership Proceedings**").

16. At the time of the Application, Hanfeng's principal asset was the issued and outstanding shares of Hanfeng China. According to Hanfeng, it was unable to continue business as a going concern due to the significant business issues with Hanfeng China. Hanfeng China had lost its business relationship with its single largest customer, had no prospect of reviving that relationship and faced insurmountable operational challenges, including a lack of demand for its products and deteriorating facilities, inventories and other assets.

17. On the Application, Hanfeng also sought and obtained an order approving the Share Transfer Agreement and Share Transfer Transaction and providing for the vesting of all of the Shares in the Purchaser free and clear of any encumbrances upon the completion of the Share Transfer Transaction.

Purchaser Fails to Make Payments

18. Under the terms of the Share Transfer Agreement, the Purchaser was obligated to make payment of the purchase price as follows:

(a) 5% of the total purchase price within seven business days of the date of the Share Transfer Agreement (the "**Deposit**");

(b) 15% of the total purchase price within ten business days of the date of Court approval of the Share Transfer Agreement (the "**Interim Payment**");

(c) 60% of the total purchase price within ten days upon the closing of the Share Transfer Transaction; and

(d) 20% of the total purchase price in promissory note to be assigned to Yu (on account of approximately 20.4% of Hanfeng China's shares owned or controlled by Yu) within ten days upon the closing of the Share Transfer Transaction.

19. The Deposit was paid, albeit late, on August 28, 2014.

20. The Purchaser failed to make the Interim Payment that was due on September 3, 2014 pursuant to the Share Transfer Agreement. The Purchaser initially blamed the failure to make the Interim Payment on its inability to obtain timely regulatory approvals required under Chinese law to procure and export foreign currency from China.

21. In the face of the Purchaser's failure to meet its payment obligations and given Yu's involvement in dealing with the Purchaser prior to the Receivership Proceedings, the Receiver engaged Yu to, among other things, facilitate communication with the Purchaser.

22. On February 11, 2015, in a good faith attempt to solve the purported regulatory issues and facilitate payment of the balance of the purchase price under the Share Transfer Agreement, the Receiver authorized Yu, on behalf of the Receiver, to enter into an escrow agreement (the "**Escrow Agreement**") with the Purchaser pursuant to which the Purchaser agreed to make the outstanding payments under the Share Transfer Agreement.

23. The Purchaser failed to make the payments required under the Escrow Agreement. The Receiver was initially informed by the Purchaser that the delay in funding the escrow account was caused by its office closure during the Chinese New Year holiday season between February 14 and March 6, 2015. However, the Purchaser later advised it was unable to make the Interim Payment on time due to its tight liquidity related to the seasonality of its business, and requested an extension of time to meet its obligations under the Escrow Agreement.

24. After numerous discussions, on March 23, 2015 the Purchaser committed to a new timeframe to fund the Interim Payment in three installments by April 30, 2015. The Purchaser again failed to meet this commitment.

Receiver's Continued Efforts to Close the Share Transfer Transaction

25. Notwithstanding the Purchaser's continued failure to meet its payment obligations under the Share Transfer Agreement, the Receiver made continued efforts to move the Share Transfer Transaction forward, including:

(a) engaging in extensive discussions with the Purchaser and Yu by phone and email in order to break through the purported impasse;

(b) meeting with Yu in person in Toronto on December 22, 2014 and May 4, 2015;

(c) requesting an in-person meeting with the Purchaser (the Purchaser requested to meet in Toronto, but subsequently advised that its representatives' visa applications were rejected by the Canadian Embassy in Beijing);

(d) requesting an in-person meeting in China, to which the Purchaser did not respond; and

(e) sending a letter dated May 22 to the Purchaser demanding the Purchaser fulfill its obligations under the Share Transfer Agreement and the Escrow Agreement.

New Information Concerning Identity of the Purchaser

26. During the course of its efforts to close the Share Transfer Transaction, the Receiver learned that contrary to the representations of Yu and Lei, the party it had been dealing with as Purchaser was not HLJ Pengcheng but rather was Harbin Pengcheng, a shell company with a confusingly similar name that is controlled by Yu.

27. Unlike HLJ Pengcheng, which is a well-established company, Harbin Pengcheng is not an operating company and was only registered on August 4, 2014 – four days before the Share Transfer Agreement was signed.

28. The Receiver further discovered that there is no connection whatsoever between HLJ Pengcheng and Harbin Pengcheng.

29. At all material times, Yu and Lei misrepresented the identity of the Purchaser and concealed Yu's personal connection to Harbin Pengcheng.

Yu Dissipates Hanfeng China's Assets

30. During the course of the Receivership Proceedings, Yu advised and assured the Receiver that Hanfeng China's operations had been dormant since April 2014. However, the Receiver discovered that between August 2014 and June 2015, Hanfeng China incurred millions of RMB in expenses, significantly more than would be expected for a nonproducing manufacturing facility (the "**Dissipated Funds**").

31. Despite requests from the Receiver and in breach of his obligations as legal representative and orders of this Court, Yu has refused to provide the Receiver with Hanfeng China's financial records and access to Hanfeng China's bank accounts. As a result, the Receiver has been unable to ascertain what happened to the Dissipated Funds, but it appears that Yu has absconded with them.

32. At least RMB 27 million has been dissipated from Hanfeng China during this period and the Receiver is concerned that the amount of the Dissipated Funds continues to grow.

33. The Receiver also discovered that under the control and direction of Yu, including while the company was purportedly dormant, Hanfeng China obtained approximately RMB 600,000,000 through various loans and other agreements as follows:

(a) RMB 170 million from the Harbin Branch of Industrial Bank Co., Ltd;

(b) RMB 220 million from China Construction Bank;

(c) RMB 190 million from China Merchants Bank;

(d) RMB 20 million from the Bank of East Asia (collectively the "**Loans**")

34. None of the Loans are reflected in the internal financial statements of Hanfeng China, and Yu has denied the existence of the Loans.

35. While the Receiver has determined based on available information that approximately RMB 600 million was borrowed by Hanfeng China under the Loans, none of the borrowed funds are (or ever have been) held by Hanfeng China. Due to Yu's actions, the Receiver has been unable to ascertain precisely what happened to these funds, but it appears that Yu has absconded with them.

36. The Loans are in default and remain outstanding liabilities for Hanfeng China. Lawsuits have been filed against Hanfeng China for recovery of the defaulted loan amounts.

Yu's Obligations

37. Yu was a member of the Board beginning in 2003. As a member of the Board, Yu owed Hanfeng fiduciary duties, including but not limited to a duty to act in good faith in the best interest of Hanfeng. Yu is also the legal representative of Hanfeng China, with responsibility under Chinese law for the administration of the company in accordance with its corporate purpose and authority to act on behalf of the company, e.g., to enter into third party transactions and other agreements.

38. In breach of his fiduciary duties to Hanfeng and his duties as legal representative of Hanfeng China, Yu failed to cooperate with the Receiver and failed to provide the Receiver with operational and financial information as requested.

39. In May 2015, as a result of Yu's failure to cooperate with the Receiver, the Receiver's ongoing investigation regarding Yu's connection to Harbin Pengcheng and concerns about deterioration of Hanfeng China's assets, the Receiver took steps to remove Yu as the legal representative and a director of Hanfeng China. Yu refused to cooperate with the Receiver's steps to register a new legal representative.

40. On July 24, 2015, in the course of the Receivership Proceedings, the Honourable Mr. Justice Conway ordered Yu to provide full and timely cooperation to the Receiver

including, but not limited to, providing the new legal representative with unfettered access to Hanfeng China's offices, facilities, books and financial records (the "**July 24th Order**").

41. On July 31, 2015, in the course of the Receivership Proceedings, the Honourable Mr. Justice Hainey further ordered Yu to provide full and timely cooperation to the Receiver including, but not limited to, surrendering of all of Hanfeng China's chops, and surrendering all of Hanfeng China's corporate licenses, certificates and registrations (the "**July 31st Order**").

42. Despite numerous requests, and in breach of both the July 24th Order and the July 31st Order, Yu has refused to co-operate with the appointment of a new legal representative, refused to provide the Receiver with access to the books and records of Hanfeng China, including financial records, bank accounts and loan information, excluded the Receiver's representatives from physically accessing Hanfeng China's facilities and otherwise prevented the Receiver from exercising any of the rights inherent in Hanfeng's ownership of Hanfeng China.

43. Yu has offered a number of purported excuses and justifications for Harbin Pengcheng's delay closing the Share Transfer Transaction and his own failure to co-operate with the Receiver. The explanations provided are not credible and are inconsistent with information gathered in the course of the Receivership Proceeding.

Breach of Fiduciary Duties

44. Yu breached his fiduciary duties to Hanfeng by misrepresenting the identity of the Purchaser in an attempt to secure Hanfeng China's assets for his own personal benefit. Yu further breached his fiduciary duties by frustrating the Receiver's efforts to protect Hanfeng China's assets for the benefit of Hanfeng and its shareholders while simultaneously dissipating Hanfeng China's assets for his personal gain. Hanfeng has suffered damages, the full particulars of which will be provided prior to trial, for which Yu is liable as a result of his breaches of fiduciary duty detailed herein.

Deceit and Fraudulent Misrepresentation

45. Despite his legal and/or equitable obligations to Hanfeng, Yu fraudulently misrepresented the identity of the Purchaser and actively concealed material facts about the true identity of the Purchaser and Yu's relationship to the Purchaser, all with intent to induce Hanfeng to enter into the Share Transfer Agreement, thereby injuring Hanfeng or knowing that injury was likely.

46. Lei fraudulently misrepresented the identity of the Purchaser and actively concealed material facts about the true identity of the Purchaser and Yu's relationship to the Purchaser, all with intent to induce Hanfeng to enter into the Share Transfer Agreement, thereby injuring Hanfeng or knowing that injury was likely.

47. Hanfeng entered into the Share Transfer Agreement with the Purchaser in reliance upon Yu and Lei's misrepresentations and as a result of their active concealment of material information.

48. Hanfeng has suffered damages, the full particulars of which will be provided prior to trial, for which Yu and/or Lei are liable as a result of the deceit or fraudulent misrepresentations committed by Yu and Lei and relied upon by Hanfeng and/or the Receiver as described herein.

Conversion

49. Yu caused Hanfeng China to spend or otherwise dissipate the Dissipated Funds, without any legitimate business purpose, thereby depriving Hanfeng of rightful possession. Yu further caused Hanfeng China to obtain the Loans, for which there was no legitimate business purpose, and absconded with the proceeds of the Loans, thereby depriving Hanfeng of rightful possession. Yu was not entitled to the benefit of any of the Dissipated Funds or the Loans.

50. Yu's subsequent transfer or use of the Dissipated Funds and the Loans amount to a conversion of funds for which Yu is liable.

Restitution

51. Yu has wrongfully obtained the funds advanced under the Loans and the Dissipated Funds. Yu is not entitled to these wrongfully obtained funds. The Receiver seeks restitution of all such amounts that Yu obtained.

Unjust Enrichment

52. Yu has been unjustly enriched by receipt of the funds advanced under the Loans and the Dissipated Funds, to the detriment of Hanfeng China and its sole shareholder Hanfeng. There is no juristic reason for Yu's enrichment since he has no legal or equitable right to these funds.

Knowing Assistance and Knowing Receipt

53. Lei knowingly received and retained the benefits of the Loans and Dissipated Funds, which Yu wrongfully obtained.

54. In addition, or in the alternative, Lei knowingly assisted Yu to wrongfully obtain the benefits of the Loans and the Dissipated Funds. Hanfeng has suffered harm as a result of Lei's knowing assistance and knowing receipt and is entitled to damages and/or restitution.

Punitive Damages

55. The misconduct of the Defendant as described herein has been high-handed, deliberate, officious and malicious as to justify an award of punitive damages.

Special Damages

56. In the circumstances described above, the Plaintiff is entitled to special damages for, *inter alia*, the cost of investigating the Defendants' conduct, costs associated with preserving Hanfeng China's assets in the face of Yu's dissipation thereof and costs incurred in Court approval and monitoring of the Share Transfer Transaction as well as costs incurred as a result of delays in closing that transaction.

57. The Receiver pleads and relies upon the *CJA*.

58. The Plaintiff proposes that this action be tried at Toronto.

March 22, 2016

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Proceeding commenced at Toronto

STATEMENT OF CLAIM

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